Part I

Section 174.-- Amortization of Research and Experimental Expenditures

26 CFR 1.174-1: Research and experimental expenditures; in general.
(Also §§ 446, 7805(b)(8); 1.174-3, 1.446-1, 301.7805-1).

Rev. Rul. 2023-8

This revenue ruling obsoletes Rev. Rul. 58-74, 1958-1 C.B. 148.

LAW AND ANALYSIS

Section 13206 of Public Law 115-97, 131 Stat. 2054 (Dec. 22, 2017), commonly referred to as the Tax Cuts and Jobs Act (TCJA), amended § 174 of the Internal Revenue Code (Code) effective for amounts paid or incurred in taxable years beginning after December 31, 2021.[1]

For amounts paid or incurred in taxable years beginning on or before December 31, 2021, former § 174(a) permitted a taxpayer to currently deduct research or experimental expenditures that were paid or incurred during the taxable year in connection with its

[1] Unless otherwise specified, all "section" or "§" references are to sections of the Code or the Income Tax Regulations (26 CFR part 1) and references to "former § 174" are to § 174 as in effect immediately prior to the effective date of the amendments made by § 13206 of the TCJA.

trade or business (expense method). Alternatively, a taxpayer could elect to defer and amortize these expenditures under former § 174(b). If expenditures were neither currently deducted nor deferred and amortized, they had to be charged to capital account. *See* § 1.174-1.

If the expense method was adopted for amounts paid or incurred in taxable years beginning on or before December 31, 2021, it had to be used for all qualifying expenditures in the taxable year adopted and for all subsequent years, unless the Commissioner of Internal Revenue or the Commissioner's delegate (Commissioner) consented to a different method for all or part of the expenditures under former § 174(a)(3). *See* § 1.174-3(a). A taxpayer on a different method could apply for permission to change to the expense method for all or part of the expenditures by submitting a written application to the Internal Revenue Service (IRS). *See* § 1.174-3 and section 7.01 of Rev. Proc. 2022-14, 2022-7 I.R.B. 502.

Rev. Rul. 58-74 provides that if a taxpayer adopted the expense method but failed to deduct expenses relating to the cost of obtaining a patent or other items of research or experimental expenditures for prior taxable years to which the expense method is applicable, the taxpayer should file a claim for refund or amended return to deduct additional research or experimental expenditures in the year or years when the expenditures were paid or accrued. Rev. Rul. 58-74 further provides that the additional research or experimental expenditures cannot be treated as deferred and amortized under former § 174(b) or chargeable to capital account and subsequently amortized or written off upon abandonment of the project or projects because the Commissioner's consent to change a method of accounting was not obtained. Accordingly, the

deduction for the additional research or experimental expenditures could be lost if the period of limitations on claims for credit or refund under § 6511 has expired and amended returns could not be timely filed.

Section 13206(a) of the TCJA amended former § 174 to require research or experimental expenditures (for amounts paid or incurred in taxable years beginning after December 31, 2021) to be charged to capital account and amortized ratably over the five-year period (or the 15-year period in the case of any specified research or experimental expenditures which are attributable to foreign research) beginning with the midpoint of the taxable year in which the specified research or experimental expenditures were paid or incurred. The rationale of the Department of the Treasury (Treasury Department) and the IRS for obsoleting Rev. Rul. 58-74 is independent of the removal of the expense method by the TCJA amendments to former § 174.

Pursuant to the authority provided under § 301.7805-1 of the Procedure and Administration Regulations, the Treasury Department and the IRS periodically obsolete rulings that are no longer determinative because: (1) the applicable statutory provisions or regulations have been changed or repealed; (2) the ruling position is specifically covered by a statute, regulation, or subsequent published position; or (3) the facts set forth no longer exist or are not sufficiently described to permit clear application of the current statute and regulations.

The Treasury Department and the IRS are obsoleting Rev. Rul. 58-74 because there are insufficient facts in the ruling to properly analyze whether the taxpayer's failure to deduct certain research or experimental expenditures, such as the cost of obtaining a patent, when it deducted other research or experimental expenditures, constituted a

method of accounting or an error. For example, Rev. Rul. 58-74 does not explain whether the taxpayer consistently treated the costs of obtaining a patent in determining its taxable income. *See Huffman v. Commissioner*, 126 T.C. 322, 354 (2006), *aff'd*, 518 F.3d 357 (6th Cir. 2008) ("[I]t is the consistent treatment of an item involving a question of timing that establishes such treatment as a method of accounting."). Rev. Rul. 58-74 also fails to describe the cause and extent of the deviation in the treatment of certain research or experimental expenditures that were not deducted. *See* § 1.446-1(e)(2)(ii)(*b*).

Whether a change in accounting treatment of amounts paid or incurred for research or experimentation expenditures constitutes a change in method of accounting or the correction of an error depends on the specific facts of a particular situation. If the facts demonstrate that a taxpayer has a change in method of accounting, then filing an amended return, refund claim, or administrative adjustment request under § 6227 (AAR), as applicable, in reliance upon Rev. Rul. 58-74 would conflict with the statutory requirement that a taxpayer must secure the consent of the Commissioner to change a method of accounting. *See* § 446(e), former § 174(a)(3), § 1.174-3(b), and § 1.174-4(b), as applicable, for the taxable years in which former § 174 was in effect. In addition, filing an amended return, refund claim, or AAR, as applicable, in reliance upon Rev. Rul. 58-74 in such a case would be inconsistent with the IRS's position that a taxpayer may not, without prior consent, retroactively change from an erroneous to a permissible method of accounting by filing amended returns. *See* § 446(e); § 1.446-1(e)(2)(i); *Capital One Fin. Corp v. Commissioner*, 659 F.3d 316, 322-23 (4th Cir. 2011); *Diebold Inc., v. United States*, 891 F.2d 1579, 1583 (Fed. Cir. 1989), *cert. denied*, 498

U.S. 823 (1990). Lastly, filing an amended return, refund claim, or AAR, as applicable, in reliance upon Rev. Rul. 58-74 in such a case would be inconsistent with the automatic change procedure for a taxpayer changing from treating research or experimental expenditures under any provision of the Code other than § 174 to treating such expenditures under former § 174 and the regulations thereunder. *See* section 7.01(2)(a)(iv) of Rev. Proc. 2022-14. For these reasons, Rev. Rul. 58-74 is no longer determinative.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 58-74 is obsoleted.

PROSPECTIVE APPLICATION

Pursuant to § 7805(b), Rev. Rul. 58-74 is obsoleted as of July 31, 2023. The obsoletion of Rev. Rul. 58-74 does not affect the characterization of the costs of obtaining a patent in § 1.174-2(a)(1). Furthermore, the obsoletion of Rev. Rul. 58-74 does not affect the specific rules for changing a method of accounting under former § 174 and the regulations under former § 174, including the requirement that such change be implemented on a cut-off basis. *See* former § 174(a)(3), § 1.174-3(b)(2), and § 1.174-4(a)(5).

A taxpayer may file a claim for refund, amended return, or AAR, as applicable, in reliance on Rev. Rul. 58-74 if the taxpayer is (1) claiming a deduction for additional research or experimental expenditures to which the expense method under former § 174(a) is applicable for the taxable year or years in which they were improperly deferred or capitalized, (2) otherwise using the expense method for such taxable year or years, and (3) timely filing the claim for refund, amended return, or AAR not later than

July 31, 2023. The eligibility to file a claim for refund, an amended return, or an AAR in reliance on Rev. Rul. 58-74 does not imply that the IRS will grant such claim for refund, amended return, or AAR. The IRS will continue to challenge the applicability of Rev. Rul. 58-74 to a particular claim for refund, amended return, or AAR when appropriate. For example, the IRS may challenge the applicability of Rev. Rul. 58-74 when the taxpayer's facts in the amended return, refund claim, or AAR are distinguishable from Rev. Rul. 58-74, including where the taxpayer failed to adopt the expense method under former § 174(a).

DRAFTING INFORMATION

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